SUPREME COURT, U. S.

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JOHN F. DAVIS, CLERK

IN THE

Supreme Court of the United States

October Term, 1968.

No. 1162.

DANICA ENTERPRISES, INC.,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit.

PETITION FOR REHEARING.

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Petitioner,

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COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR REHEARING.

Petitioner, Danica Enterprises, Inc., hereby prays that this Court grant rehearing of its order of June 2, 1969, denying the petition for a writ of certiorari to review the two-to-one judgment of the United States Court of Appeals for the Second Circuit in the above-captioned case, as prayed for in the Petition filed by Danica Enterprises, Inc. on March 15, 1969, herein.

REASONS FOR GRANTING REHEARING AND ISSUING THE WRIT.

1. The question presented is:

In March 1958, Victor Borge ("Borge") transferred to Danica Enterprises, Inc. ("Danica"), the taxpayer, in exchange for its stock, the assets of the rock cornish hen business which Borge had previously owned and operated as an individual. Borge had incurred losses in the hen business in excess of $50,000 in each of the preceding four years (1953-1957). In each of Danica's three subsequent fiscal years after its acquisition of the hen business from Borge (1958-1961), Danica itself sustained out-of-pocket annual operating losses in the hen business in excess of $50,000 per annum. The Commissioner disallowed Danica's deductions for its 1958-61 losses in the hen business to the extent that they exceeded $50,000 per annum. He reasoned that if Borge, as an individual, had sustained in 1958 a fifth consecutive year of losses in excess of $50,000 per annum, § 270 of the Internal Revenue Code (which applies to individuals and not to corporations) would have required Borge to recompute his income tax for all five years, so as to limit his deductions for such losses to $50,000 per annum. However, rather than recomputing Borge's individual taxes under § 270 for the earlier years in which he owned the hen business, the Commissioner sought, under § 269, to deny Danica its right to deduct its own subsequent out-of-pocket operating losses incurred after it acquired the hen business from Borge. The Commissioner was upheld by the Tax Court and by a divided panel of the Court of Appeals for the Second Circuit. However, the Court of Appeals explicitly noted that its decision was in conflict with the decisions of the Court of Appeals for the Third and Sixth Circuits, which have held that post-acquisition operating losses cannot be disallowed under § 269. Therefore, the question presented is:

When persons acquire control of a corporation by transferring a business to it in exchange for stock, does § 269 authorize the Commissioner to disallow post-acquisition real out-of-pocket operating losses the corporation subsequently sustains in the business?

2. At the time of this Court's order of June 2, 1969, five federal courts of appeals had considered the issue, and had reached conflicting decisions, as to whether § 269 of the Internal Revenue Code of 1954[1] could be utilized to disallow to a corporation, valid out-of-pocket post-acquisition losses sustained by the corporation in its operation of a business it had acquired from another.[2] When the Petition was filed in this case the position of the Commissioner, based upon his prior arguments in those five cases, was extremely muddled. Indeed, the Commissioner, as discussed in point 5 below, sought and obtained three extensions of time from this Court to file his Brief. In his Brief in Opposition, the Commissioner took the position not only that § 269 was broad enough to permit the disallowance of post-acquisition losses, but also that it should be utilized in the administration of the federal tax laws as a deliberately vague device to inhibit possible alleged misuses of the corporate form. The Commissioner declared that "The sweeping language of the statute and its legislative history show that it was intended to have a broad *in terrorem* effect upon the use of the corporate form to avoid or diminish tax consequences that would otherwise be incurred."[3] Not only is this position in direct conflict with the decision in *Herculite Protective Fabrics, Inc. v. Commissioner,* 387 F. 2d 475 (3d Cir. 1968), but it is also at variance with the underlying purpose

1. 26 U. S. C. § 269.

2. The decisions of five courts of appeals are set out and analyzed on Pages 9 through 12 of the Petition.

3. Brief in Opposition, p. 4.

of § 269. As Chief Judge Aldrich noted in dissent in *R. P. Collins and Company v. United States,* 303 F. 2d 142, 148 (1st Cir. 1962), the use of § 269 to disallow post-acquisition losses "would go far beyond the policy of a statute to obviate tax-avoidance, and would constitute a penalty rather than a cure." In light of the Commissioner's extreme position, adopted in his Brief in Opposition in the present case, it is respectfully submitted that this Court must authoritatively determine whether § 269 can appropriately be construed in such a broad manner, especially in light of the fact that four of the five courts of appeals which have considered the matter—and apparently the Commissioner as well in those cases—have not felt that it could.

3. The Second Circuit conceded that its decision in the instant case conflicts with the decisions on the identical point of the Third and Sixth Circuits (Appendix B to Petition, p. 16a). *Herculite Protective Fabrics Corp. v. Commissioner,* 387 F. 2d 475 (3rd Cir. 1968); *Zanesville Investment Co. v. Commissioner,* 335 F. 2d 507 (6th Cir. 1964). The Rules of this Court suggest that where there is a conflict, the Writ will be granted. Rules of the Supreme Court of the United States, Rule 19(1)(b). The Commissioner has conceded that there is such a conflict (Brief in Opposition, pp. 7, 10).

4. Resolution of this question at this time is of large practical importance in the day-to-day administration of the federal tax laws. As pointed out in the Petition at Page 13, the question is an important and recurring one, as is demonstrated both by the number of cases pending under Section 269—500 as of October 25, 1968—and by the potential impact of the Commissioner's present expansive view of the Section. As his Brief in Opposition demonstrates, the Commissioner in his labored attempts to distinguish the

conflicting decisions of the courts of appeals[4] has failed to give any clear guide to the courts or to the Service which would clear up the confusion evidenced by the three fundamentally different approaches by the courts of appeals as to the interpretation and application of Section 269 to post-acquisition losses. Indeed, the Commissioner conceded that, on the basic question involved here, two of the five decisions are in direct conflict.[5] Petitioner submits that the issue on which this conflict exists extends to all five cases. Thus, unless this Court promptly resolves this question, the courts of appeals in at least two, and probably five, circuits will be left in a situation of great confusion, with no guide to the resolution of the significant and recurring problem presented by this case.

5. Petitioner filed its Petition for a Writ of Certiorari on March 15, 1969, and the Commissioner requested and obtained three extensions. On May 19, 1969 the Commissioner finally served on Petitioner page proofs of its Brief in Opposition but did not file with the Court until several days later the actual Brief in Opposition. Petitioner immediately began to prepare a Reply Brief which was sent to the printer in time. However, because of the holiday, May 30, and the ensuing weekend, the printer did not return the Reply Brief to Petitioner until June 2 at which time it was immediately filed with the Court. It was returned by the Clerk of the Court since on the same day this Court entered the Order denying the Petition for a Writ of Certiorari. Thus the Court did not have the benefit of Petitioner's Reply Brief which we think clearly answers the argument made by the Commissioner. Copies of the Reply Brief are being filed with the Court for reference if the Court desires.

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4. Brief in Opposition, pp. 7 through 11.
5. Brief in Opposition, p. 10.

CONCLUSION.

For the reasons set forth above and in the Petition for a Writ of Certiorari, it is respectfully urged that rehearing be granted and that, upon such rehearing, a Writ of Certiorari issue to the United States Court of Appeals for the Second Circuit.

Respectfully submitted,

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Dated: June 24, 1969.

CERTIFICATE OF COUNSEL.

I hereby certify that the foregoing petition for rehearing is presented in good faith and not for delay and is restricted to the grounds specified in Rule 58(2) of the Rules of this Court.

WILLIAM T. COLEMAN, JR.,
Counsel for Petitioner.

CERTIORARI DENIED